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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 000222

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DEPT FOR EUR/RUS, FOR EEB/ESC/IEC GALLOGLY AND WRIGHT
EUR/CARC, SCA (GALLAGHER, SUMAR)
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SUBJECT: ENI RUSSIA CHIEF ON SOUTH STREAM, GAZPROM

REF: SOFIA 48

Classified By: DCM Daniel A. Russell for Reasons 1.4 (b/d)

11. Summary: (C) Ernesto Ferlenghi, Chief Representative of ENI Russia/CIS, told us January 28 that South Stream is not a competitor to Nabucco because European demand will absorb gas from all currently planned pipelines, "and even more." He said he will say as much to the EU Energy Commission when he briefs them on South Stream on January 29. Ferlenghi added that ENI has "never had a problem" with Gazprom and is "very comfortable" with its partnership with the company. Finally, he described the senior leadership of the company, including President Putin's designated heir Gazprom Chairman Dmitriy Medvedev, as smart and knowledgeable. End summary.

SOUTH STREAM NOT A COMPETITOR OF NABUCCO

12. (C) In a January 28th meeting, Ernesto Ferlenghi, chief Russia/CIS representative for Italian oil and gas firm ENI, said he has been called to Brussels for a meeting January 29th to brief the EU Energy Commission on South Stream. He said ENI's message will be that South Stream is not a competitor to Nabucco. In fact, all the currently planned pipelines combined, including South Stream, Nabucco, and Nord Stream, would still not satisfy Europe's projected medium-term gas demand. He added ENI believes that Europe should be looking to further connect itself by pipeline to Russia as the escalating costs of LNG terminals make pipelines a more economic option and Russia is the only gas exporter in the region with the capacity to supply them.

RECENT DEVELOPMENT ENHANCE PROJECT'S VIABILITY

13. (C) Ferlenghi said ENI is a 50-50 owner of the gas in the South Stream pipeline. He noted ENI's CEO was present at the signing of the deal with Bulgaria on January 18th (reftel) where Gazprom agreed to give 50% ownership of the pipeline itself (including transit fees) on Bulgarian territory to Bulgaria. According to Ferlenghi, the agreement with Bulgaria provides critical host government support on a range of issues, including fiscal treatment of the pipeline that could have otherwise negatively impacted the project. He said the situation is similar in Serbia, where Gazprom agreed

to give Serbia a 49% stake in the pipeline over its territory.

14. (C) Ferlenghi said that ENI and Gazprom have formed a Switzerland-based company (South Stream A.G.) to complete the feasibility and marketing studies needed to make the pipeline a reality. These studies are expected to be completed by early 2009 and will determine the exact route of the pipeline and its branches. He conceded that the 2013 date touted by Gazprom as the target for first gas deliveries is very optimistic. He maintained, however, that South Stream will be profitable and economic. Countering criticism of the logistical difficulties of constructing a pipeline under the Black Sea, Ferlenghi recounted similar concerns about the Blue Stream gas pipeline from Russia to Turkey, which is now not only profitable for ENI but also helped launch the reputation of its construction subsidiary, Saipem.

"VERY COMFORTABLE" WITH GAZPROM

15. (C) Ferlenghi described ENI's relationship with Gazprom as "very comfortable" and called the company a reliable and trusted partner. ENI formed a strategic alliance with Gazprom in November 2006, and Gazprom maintains an option to buy 51% of an ENI-ENEL (another Italian firm) joint venture that owns licenses to promising fields in the Yamal Peninsula. He said ENI has no problem with the de-facto requirement of being limited to a minority position in Russia. Ferlenghi said his company has had a productive business relationship with Russia since 1955 and operated successfully in the gas sector here for 38 years. According to Ferlenghi, Gazprom's standard requirement for partnership

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in Russia is reciprocal partnership arrangements in projects abroad. Gazprom, which is considering buying into ENI assets in Libya, Tunisia, and Algeria, would be welcomed by ENI as a partner anywhere in the world.

16. (C) Ferlenghi, who has been in Russia for 10 years, said a gas company needs to be in Russia for the long-term and to work constructively with Gazprom and the GOR. "Once you are allied with Gazprom, you really appreciate the power of the state; problems are taken care of." He accepted that Gazprom operates inefficiently and non-transparently, but downplayed those shortcomings, stressing that ENI's partnership with Gazprom has served shareholders very well. He also praised Russia's relative stability in a world dominated by unstable and inhospitable oil and gas producing countries, specifically mentioning ENI's troubles in Venezuela. "Russia is more stable than Italy," he joked.

17. (C) On his dealings with Gazprom leadership, Ferlenghi said it was no easy feat getting Gazprom to agree to a 50-50 deal on South Stream, since Gazprom had demanded throughout that it be the majority partner. He added that the top management -- specifically Deputy CEO and head of Gazprom Export Alexander Medvedev -- is very western in its thinking and interested in efficiency. He stressed that Alexander Medvedev is "very tough," and praised him as a "true expert" in gas matters. He said he has been in meetings with Gazprom Chairman (and Putin's designated successor) Dmitriy Medvedev seven times, and found him to be intelligent, knowledgeable, and easy to deal with. He confirmed, however, that Gazprom CEO Aleksey Miller was the main decision maker at Gazprom and that Dimitriy Medvedev's role was more one of political facilitator.

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